



## PRICING YOUR DEFINED CONTRIBUTION PLAN (Recordkeeping Services)

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Per ERISA, Defined Contribution (DC) plan sponsors (fiduciaries) are required to ensure that their service provider fees and associated contracts are “reasonable”. Critical in fulfilling this requirement is understanding the methodology by which plan-related fees are calculated. Depending on the methodology, service provider compensation can increase relative to services provided over the life of a contract. This can push fees into unreasonable territory which increases fiduciary liability exposure. In this short paper, we discuss how fee calculation methodologies can specifically impact costs associated with recordkeeping. Please note that plan sponsors can and should choose the pricing structure (calculation methodology) that most appropriately fits their needs in order to best meet their fiduciary obligations.

To accurately determine the reasonability of recordkeeper compensation over the duration of the contract, the plan sponsor must:

- be able to determine their **total hard dollar (\$) fees paid to the recordkeeper** for this period
- ensure the hard dollar (\$) fees for this period are **consistently in-line with and/or tied to the services provided**

In this paper, we examine the two most commonly used recordkeeper pricing models to determine whether these two conditions are met. Furthermore, we discuss each model’s impact on a sponsor’s fiduciary liability exposure and a participant’s account balance.

These two fee models are summarized below and discussed on the following pages:

Table 1.0: FIXED-BPS ASSET-BASED MODEL	Table 1.1: FIXED-DOLLAR PER-PARTICIPANT MODEL
<p><b>Recordkeeper compensation calculation:</b>            Asset level (\$) x Basis point (bps) fee            Example: \$100 million (assets) x 20 bps = \$200,000 <sup>1</sup></p>	<p><b>Recordkeeper compensation calculation:</b>            Number of participants (#) x fixed-dollar per-participant fee (\$)            Example: 2,500 participants x \$80 per-participant = \$200,000 <sup>1</sup></p>
<p><b>Recordkeeping compensation driver <sup>2</sup>:</b></p> <ul style="list-style-type: none"> <li>• Higher asset levels increase compensation</li> <li>• Lower asset levels decrease compensation</li> </ul>	<p><b>Recordkeeping compensation driver:</b></p> <ul style="list-style-type: none"> <li>• Higher participant count increases compensation</li> <li>• Lower participant count decreases compensation</li> </ul>
<p><b>Summary</b></p> <ul style="list-style-type: none"> <li>• Recordkeeping fees are tied directly to the plan’s assets, yet asset levels do not impact a recordkeeper’s workload</li> <li>• Fees are not predictable as asset levels fluctuate based on contributions, withdrawals, fund performance, etc.</li> </ul>	<p><b>Summary</b></p> <ul style="list-style-type: none"> <li>• Recordkeeping fees are directly tied to recordkeeper workload which is driven by number of participants in plan</li> <li>• Provides for predictable, transparent, and controllable recordkeeping costs for the duration of contract</li> </ul>
<p><b>Notes</b></p> <ul style="list-style-type: none"> <li>• A “fixed-bps” fee is negotiated at outset of contract and remains static for duration of contract. A “variable bps” fee (often tied to certain fund and share class requirements) fluctuates for duration of contract.</li> </ul>	<p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>• A “fixed-dollar per-participant” fee is negotiated at outset of contract and remains static for duration of contract</li> <li>• Fees may be subject to modification if material change to participant count occurs (i.e. merger / acquisition)</li> </ul>

<sup>1</sup> Examples illustrative of a one year contract period

<sup>2</sup> In rare instances, a “variable” bps fee model will not increase recordkeeper compensation if assets move from investments with higher revenue share to investments with lower revenue share and vice versa.

NOTE: Transaction fees charged directly to participants (i.e. loan, QDRO processing) are not addressed in this analysis. Consideration, however, should be given to these costs when evaluating the overall cost structure of a recordkeeper’s services.

**FIXED-BPS ASSET-BASED MODEL (x bps)**

Hard dollar recordkeeper compensation in a fixed-bps asset-based model (*assets times x bps*) is driven by fluctuating plan asset levels, yet assets have no impact on a recordkeeper’s workload (# of participants do). Positive investment performance and plan contributions increase assets, which in turn, increase recordkeeper compensation (*and vice versa*). Typically, a plan’s assets will increase over the duration of a contract due to long-term investment and contribution trends. Unless participant count increases at the same (*or a greater*) rate, typically not the case, the recordkeeping cost of each participant will increase. Linking recordkeeper fees to assets may be viewed as unreasonable.

**Example:** The annual recordkeeper compensation for a \$100 million plan that is priced at 20 bps would be \$200,000 ( $\$100\text{ mx} \times 20\text{ bps}$ ). If plan asset growth is +7% in year 1 ( $\$100\text{ mx} \times 7\% = \$7\text{ mx}$ ), holding all other factors steady, annual fees grow to \$214,000 ( $\$107\text{ mx} \times 20\text{ bps}$ ) at the end of year 1. Translated to an “effective” fixed-dollar per-participant rate, assuming 2,500 participants, the cost of recordkeeping each participant increased from \$80 ( $\$200,000 / 2,500$ ) at contract inception to \$86 ( $\$214,000 / 2,500$ ) at end of year 1 – a 7% “raise” for the recordkeeper without incurring any additional work.

**THE POTENTIAL LONG-TERM IMPACT OF YOUR PRICING METHODOLOGY** - note color link to table below

The following example (Table 1.2 below) illustrates each model’s long-term impact (5-years) on fees by using each methodology to price the same plan. For simplicity, we assume a 7% annualized plan asset growth rate and hold participant count steady.

At contract inception, the total “annual” recordkeeping fees for both **Model A (fixed-bps)** and **Model B (fixed-dollar)** equal **\$200,000**. As assets begin to rise in year 1 ( $\$100\text{ mx}$  to  $\$107\text{ mx}$ ), however, the cost to recordkeep each participant using **Model A** increases – By the end of year 1, **Model A** annual costs increase to **\$214,000** yet costs for **Model B** remain static at **\$200,000**. By the end of year 5, annual fees for **Model A** (**\$280,510**) are **\$80,510** higher than for **Model B** (**\$200,000**), a 40% increase.

Some recordkeepers allow a hard dollar revenue “cap” to limit costs from becoming unreasonable. In this situation, it’s appropriate to also set a hard dollar revenue “floor” to ensure the recordkeeper is fairly compensated if assets significantly decrease.

**FIXED-DOLLAR PER-PARTICIPANT MODEL (\$x per-participant)**

Hard dollar recordkeeper compensation in a fixed-dollar per-participant model ( $\$x\text{ per-participant}$ ) is driven by fluctuating participant count. In general, recordkeeper compensation increases with more participants and decreases with fewer participants. This model directly links fees to workload, as it generally costs the recordkeeper the same (\$) to recordkeep each participant in a specific plan (*excluding individual transaction fees*). In this manner, fees are consistently aligned with the recordkeeper’s workload, are predictable and transparent, and maintain the best chance to remain reasonable.

**Example:** The annual recordkeeper compensation for a plan with 2,500 participants that costs \$80 per-participant is \$200,000 ( $2,500 \times \$80$ ). If the plan grows to 2,600 participants in year two, the sponsor knows the recordkeeper’s compensation is \$208,000 ( $2,600 \times \$80$ ). The cost of recordkeeping each participant remains static at \$80. Plan assets have no impact on recordkeeper fees.

Translated into an “effective” fixed-dollar per-participant fee, **Model A** now costs **\$112** per-participant ( $\$280,510 / 2,500$ ) while **Model B** remains at **\$80**.

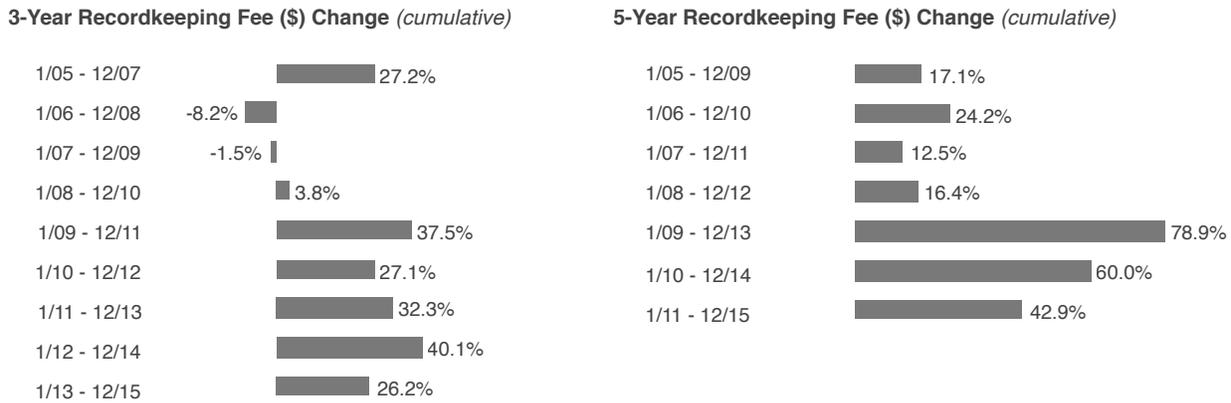
Looking at the full 5-year period, a plan utilizing **Model A** incurred **\$230,658** in additional fees (or **\$18** per-participant) vs. **Model B** – a variation of 22.5%.

Note that a rising participant count (*over time*), in a **fixed-bps asset-based** model, reduces the negative impact vs. a **fixed-dollar per-participant** model while a falling participant count increases it. Participant growth (%) needs to match asset growth (%) for a neutral impact between models. Traditionally, asset growth rises faster than participant growth over a multi-year period, thus making a **fixed-bps asset-based** model advantageous for the recordkeeper and disadvantageous for the plan. This can be further amplified if the plan also uses the recordkeeper’s proprietary investments.

Table 1.2: ASSUMPTIONS	Inception	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5	Total / Average
Plan Asset Levels (7% annual growth)	\$100,000,000	\$107,000,000	\$114,490,000	\$122,504,300	\$131,079,601	\$140,255,173	-
Participant Count	2,500	2,500	2,500	2,500	2,500	2,500	-
<b>MODEL A: Fixed-bps Asset-based Fee (bps)</b>							
Annual bps Fee	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%
Total Plan Recordkeeping Fees (\$)	\$200,000	\$214,000	\$228,980	\$245,009	\$262,159	\$280,510	\$1,230,658
“Effective” Fixed-dollar Per-Participant Fee	\$80	\$86	\$92	\$98	\$105	\$112	\$98
<b>MODEL B: Fixed-Dollar Per-Participant Fee (\$)</b>							
Annual Per-Participant Fee	\$80	\$80	\$80	\$80	\$80	\$80	\$80
Total Plan Recordkeeping Fees	\$200,000	\$200,000	\$200,000	\$200,000.00	\$200,000	\$200,000	\$1,000,000
<b>COMPARISON (Model A vs. B)</b>							
Plan Recordkeeping Fees (difference)	-	\$14,000	\$28,980	\$45,009	\$62,159	\$80,510	\$230,658
Fixed-dollar Per-Participant Fee (difference)	-	\$6	\$12	\$18	\$25	\$32	\$18

## THE MARKET'S IMPACT ON RECORDKEEPING FEES IN RECENT YEARS

Investment performance plays a key roll in driving DC recordkeeping costs in a **fixed-bps asset-based** model. To analyze the historical impact, we created a hypothetical plan portfolio allocation. The portfolio consists of 50% US Equity (*Russell 3000 Index*), 10% Foreign Equity (*Russell Global ex-US Index*), 30% US Fixed Income (*Barclays US Aggregate Bond Index*) and 10% Money Market (*BofAML US Treasury 91 day Index*) and is rebalanced monthly. We then calculated cumulative 3- and 5-year portfolio returns on a calendar year basis. The returns noted below illustrate the percentage increase in total recordkeeping costs (*relative to a static participant base*) for plans using a **fixed-bps asset-based** fee model. At the extreme, a contract inception near the bottom of the bear market in 2009 would have experienced a nearly 80% increase in the cost to recordkeep each participant over the following five year period (*assuming fees were not renegotiated*).



## A NOTE ON RECORDKEEPER FINANCING

Please note that the “pricing” methodology chosen by the sponsor does not need to determine how the fees are “financed” (*paid for*). For example, one could price their plan on a **fixed-dollar per-participant** basis yet choose to pay for these costs in bps, either through a participant account fee or via fund offset (revenue share) generated by the plan’s investment options. At Gosselin Consulting Group, we prefer plans utilize participant account fees, typically equal-weighted, rather than fund offset in order to avoid participant subsidization. For more information, please see Gosselin Consulting Group’s paper “Financing Your Defined Contribution Plan”.

## ENSURING FAIR COMPENSATION FOR THE RECORDKEEPER

While a **fixed-bps asset-based** model favors recordkeepers in positive market and contribution environments, one must consider that the opposite also holds true. Falling market and high withdrawal environments negatively impact plan asset levels, thus decreasing recordkeeper compensation. For **fixed-dollar per-participant** fee models, the recordkeeper compensation remains static based on number of participants, eliminating any volatility in compensation (*better or worse*) beyond the quoted price. Ensuring fair recordkeeper compensation is an important consideration, as in order to remain best-in-class, recordkeeping organizations must be profitable. This allows for re-investment in their business, retention of high quality personnel, and advancements in technology.

## MEETING YOUR FIDUCIARY DUTY

ERISA requires plan sponsors to ensure reasonability of their service provider contract and related fees — yet the definition of “reasonable” is not black and white. It is important to recognize that “reasonable” is not synonymous with “cheapest”. The value of the services provided by the recordkeeper should be the focus of any fee discussion, and ensuring a thorough understanding of the pricing options available should be viewed as a fiduciary obligation. At Gosselin Consulting Group, we believe that utilizing a predictable and transparent **fixed-dollar per-participant** fee structure strengthens the fiduciary position of the plan sponsor and best ensures fee reasonability over the long-term.

**Please see Table 1.3 on following page for additional detail related to DC recordkeeper pricing strategies.**

## IMPORTANT DISCLOSURE

The views and opinions expressed in this document solely reflect those of Gosselin Consulting Group LLC as of August 2016. They should not be construed as investment advice or recommendation by Gosselin Consulting Group LLC and are subject to change without notice based on market and other conditions.

The factual information contained herein is obtained from third-party sources and believed to be reliable, but its accuracy, completeness, or correctness is not guaranteed.

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**Table 1.3: SUMMARY OF STRATEGIES TO PRICE RECORDKEEPING SERVICES**

*Higher Fiduciary Risk <sup>1</sup>*

*Lower Fiduciary Risk <sup>1</sup>*

	Variable-bps Asset-based (bps)	Fixed-bps Asset-based (bps)	Flat Dollar Plan Fee (\$)	Fixed-Dollar Per- Participant Fee (\$)	Hybrid
<b>Calculation</b>	x bps (%) – “x” varies by asset allocation <sup>2</sup>	y bps (%) <sup>2</sup>	“x” dollars (\$)	“x” dollars (\$) per-participant	Varies
<b>Recordkeeper Compensation Fee Drivers</b>	Plan asset level & participant asset allocation  (influenced by investment managers, market performance, contributions/withdrawals/transfers, etc.)	Plan asset level	Plan metrics at contract inception	# of participants	Varies
<b>Are Fees Tied Directly to Recordkeeping Services?</b>	No	No	Yes	Yes	Varies
<b>Are Fees Tangible, Predictable, and Consistent for Duration of Contract?</b>	No	No	Yes	Yes	Varies
<b>Notes</b>	<ul style="list-style-type: none"> <li>• usually requires proprietary options</li> <li>• may require minimum proprietary asset balance</li> <li>• important to implement fee (\$) ceiling and floor into contract</li> </ul>	<ul style="list-style-type: none"> <li>• may require proprietary options</li> <li>• important to implement fee (\$) ceiling and floor into contract</li> </ul>	<ul style="list-style-type: none"> <li>• full open architecture</li> </ul>	<ul style="list-style-type: none"> <li>• full open architecture</li> </ul>	<ul style="list-style-type: none"> <li>• may require proprietary options</li> <li>• important to implement fee (\$) ceiling and floor into contract</li> </ul>

<sup>1</sup> Ranking of fiduciary risk across the spectrum above may change based on the specificities of each model and contract

<sup>2</sup> Calculated daily, monthly, or quarterly for duration of contract